COMMENTS
to the
Office of Personnel Management
5 CFR Parts 831, 841
RIN 3206-AM17
Railroad Retirement Board
20 CFR Part 350
RIN 3220-AB63
Social Security Administration
20 CFR Parts 404, 416
RIN 0960-AH18
Department of the Treasury
Fiscal Service
31 CFR Part 212
RIN 1505-AC20
Department of Veterans Affairs
38 CFR Part 1
RIN 2900-AN67

by the **National Consumer Law Center**
on behalf of its low-income clients
and for the following national, state and local
advocates for low and moderate income recipients of federal benefits
Center for Responsible Lending
Consumer Action
Consumer Federation of America
Consumers Union
National Association of Consumer Advocates
National Legal Aid and Defender Association
Public Citizen
Arizona Consumers Council of Phoenix, Arizona
Legal Aid of the Bluegrass of Covington, Kentucky
Michigan Poverty Law Program of Ann Arbor, Michigan
Legal Aid of Western Michigan of Grand Rapids, Michigan
Mississippi Center for Justice of Jackson, Mississippi
Consumers League of New Jersey
Consumers League Education Fund of Montclair New Jersey
North Carolina Justice Center of Raleigh, North Carolina
South Carolina Appleseed of Columbia, South Carolina
Blue Ridge Legal Services of Harrisonburg, Virginia
Legal Aid Justice Center of Charlottesville, Virginia
Southern Area Agency on Aging of Martinsville, Virginia
Legal Aid Society of Milwaukee, Wisconsin
Mountain State Justice of Charleston, West Virginia

June 18, 2010

The **National Consumer Law Center**[1] ("NCLC") submits the following comments on behalf of its low-income clients, as well as on behalf of the many legal services, consumer, and advocacy organizations listed in the heading.

> *Allene Bellendier, a disabled 70-year-old widow, used to have her Social Security benefit deposited directly into her SunTrust Banks Inc. account.*
> *But she closed her account last year after the bank froze it twice. Though she was able each time to get the account released with the help of a legal-aid lawyer, the process took weeks, leaving her without money for food, medicine or mortgage payments. When her food ran out, she says, she searched the house for loose change and found a few dollars in a piggy bank she was saving for Christmas presents.*
> *She had a heart attack and says she lost nearly $600 in penalties and fees to companies where she had bounced checks as a result of the hold. Mrs. Bellendier now has her granddaughter cash the check at Wal-Mart; Mrs. Bellendier buys money orders to pay her monthly bills.*
> *SunTrust declined comment.*
>
> Excerpt from Ellen Schultz, *Closing the Benefits Loophole*, Wall Street Journal, May 30, 2009.

Legal aid lawyers throughout the nation have similar stories to tell about the harsh effects of the garnishment of government benefits. In fact, dozens of these stories from all over the country have been described to Congress[2] and in the press.[3] But soon, these stories will be relegated to the status

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[1] The **National Consumer Law Center, Inc. (NCLC)** is a non-profit Massachusetts Corporation, founded in 1969, specializing in low-income consumer issues, with an emphasis on consumer credit. On a daily basis, NCLC provides legal and technical consulting and assistance on consumer law issues to legal services, government, and private attorneys representing low-income consumers across the country. NCLC publishes a series of eighteen practice treatises and annual supplements on consumer credit laws, including *Consumer Banking and Payments Law* (4d ed. 2009), which has several chapters devoted to electronic commerce, electronic deposits, access to funds in bank accounts, and electronic benefit transfers. NCLC also publishes bimonthly newsletters on a range of topics related to consumer credit issues and low-income consumers. NCLC attorneys have written and advocated extensively on all aspects of consumer law affecting low-income people, conducted trainings for tens of thousands of legal services and private attorneys on the law and litigation strategies to deal with the electronic delivery of government benefits, predatory lending and other consumer law problems, and provided extensive oral and written testimony to numerous Congressional committees on these topics. NCLC's attorneys have been closely involved with the enactment of all federal laws affecting consumer credit since the 1970s, and were very involved in the development of rules implementing EFT-99 after its enactment in 1996. NCLC's attorneys regularly provide comprehensive comments to the federal agencies on the regulations under these laws. These comments are written by NCLC attorneys Margot Saunders and Leah Plunkett.

[2] The stories of these problems have been documented extensively in the press and in Congressional testimony. Personal stories from client of legal services attorneys from Alabama, Georgia, Illinois, Michigan, Mississippi, Montana, Nevada, New Jersey, New York, Pennsylvania, and Virginia were included in testimony presented to a subcommittee of the House Ways and Means Committee in June 2008. *See Protecting Social Security Benefits from Predatory Lending and Other Harmful Financial Institution Practices: Hearings Before the Subcomm. on Social Security of the H. Comm. on Ways and Means,* 110th Cong. (2008), *available at* http://www.consumerlaw.org/issues/debt_collection/content/June08HouseTestimony.pdf (testimony of Margot Saunders, National Consumer Law Center).

of legal aid lore. **The joint rule proposed by the Treasury Department and other federal agencies to address these problems will stop these problems cold**.[4] This rule is truly an amazing and wonderful thing: with a few added pages of federal regulations, hundreds of thousands of federal benefit recipients will *no longer be harmed by the illegal garnishment of federal payments.*

The rule is excellent but not perfect. To prevent unintended consequences, the rule needs a few necessary tweaks and important additions. The most essential changes are:

- The 60 day lookback period needs to be 65 days.
- The safe harbor provided to financial institutions needs to be more carefully delineated and in one respect broader: it should protect banks from liability when they release funds which are clearly exempt but are not included in the protected amount to account holders.
- The rule needs to clarify that the "protected amount" cannot be challenged by creditors as non-exempt and that financial institutions must provide full and customary access to the protected amount.
- The protected amount should be determined in the aggregate – by adding all the direct deposits made during the lookback period, and protecting that amount – even if some of the funds are not in the same accounts to which they were originally electronically deposited.
- The rule should clearly prohibit the practice of taking garnishment fees from exempt funds which are not included in the protected amount.

Additionally, Treasury should take this opportunity to establish the use of the accounting rule whenever there is a challenge to the exemptions taken in a bank account. Treasury has articulated a clear, easy to follow, completely legal accounting rule to determine which commingled funds are actually federally-exempt funds. Treasury should mandate that this simple rule *always* be the one used when courts are delineating federally exempt funds in commingled accounts.

In Section I, we explain the justification for the proposed rule. In Section II, we provide support for and suggestions relating to subsections of the proposed rule, as well as additional recommendations to ensure that the proposed rule accomplishes its intended purposes.

I. Despite Clear Law, Current Practice Leaves Tens of Thousands Destitute.

We estimate that on a monthly basis, *over a hundred thousand low-income recipients of Social Security, Supplemental Security Income ("SSI"), and other federal payments whose benefits are entirely exempt from*

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[3] *See, e.g.* Ellen E. Schultz, *The Debt Collector vs. The Widow: Viola Sue Kell thought her Social Security benefits were safe in the bank. She was Wrong*. WALL ST. J., April 28, 2007, at A1; *also see, As Federal Agencies Push for Recipients to Use Direct Deposit, Consumer Advocates Warn of Risks,* CHRISTIAN SCI. MON., March 14, 2007; Ellen Schultz*, "Closing the Benefits Loophole,"* WALL ST. J., May 30, 2009.

[4] In the balance of these comments, we use the shorthand "Treasury" to refer to the promulgator of the proposed rule, rather than list out each of the responsible agencies: the Office of Personnel Management, the Railroad Retirement Board, the Social Security Administration, and the Department of Veterans Affairs.

claims of judgment creditors are left temporarily destitute when banks allow attachments and garnishments to freeze the recipients' bank accounts. This is a low estimate, so the real number is likely much higher.[5]

A. The Law: Exempt Benefits Must Be Protected.

To preserve federal benefits for their intended recipients, Congress provided that the benefits cannot be seized to pay debts, as such seizures would result in the loss of subsistence funds. Each of the statutes governing the distribution of these funds specifically articulates that these funds are to be free from attachment or garnishment or other legal process. The Social Security Act says:

> The right of any person to any future payment under this subchapter shall not be transferable or assignable, at law or in equity, and none of the moneys paid or payable or rights existing under this subchapter shall be subject to execution, levy, attachment, garnishment, or other legal process, or to the operation of any bankruptcy or insolvency law.[6] (emphasis added)

[5] This number is a very conservative estimate. First, we derive a number for how many Social Security and SSI recipients have judgments for defaulted credit card debt taken against them each year. In recent years, credit card default rates have risen and fallen again. The figures from 2008 are a safe middle ground to begin the analysis. Information from Moody's Investors Service, a bond-rating service, reported the charge-off rate for credit card debt at 5.7% in May 2008, up from 4.5% the previous year. *Sector Snap: Credit card companies fall on outlook*, MSN MONEY, May 20, 2008, at http://news.moneycentral.msn.com/provider/providerarticle.aspx?feed=AP&date=20080520&id=8671348.

If we assume that Social Security and SSI recipients carry and default on credit cards at the same rate as the general population, this would mean that about 3.31 million of the country's 58 million Social Security and SSI recipients would have judgments taken against them for credit card debts each year. Even if we take the conservative approach of reducing this number by 50% because it is an extrapolation, there are still well over 1.65 million recipients of Social Security and SSI who have credit card judgments taken against them each year. And this figure represents only judgments on credit card debt. On a monthly basis, that translates to **over 137,000 Social Security and SSI recipients that have judgments against them *each month***. If we count the additional tens of thousands of judgments taken against these same recipients for medical debt and deficiency judgments for repossessed vehicles and foreclosed homes, the numbers of recipients with unpaid judgments each month would be even higher.

[6] 42 U.S.C. § 407(a). The protections are similar in the other federal statutes governing federal benefits:

- Veterans benefits: Payments of benefits due or to become due under any law administered by the Secretary shall not be assignable except to the extent specifically authorized by law, and such payments made to, or on account of, a beneficiary shall be exempt from taxation, shall be exempt from the claim of creditors, and shall not be liable to attachment, levy, or seizure by or under any legal or equitable process whatever, either before or after receipt by the beneficiary. 38 U.S.C. § 301(a)(1).
- Railroad Retirement benefits: Except as provided in subsection (b) of this section and the Internal Revenue Code of 1986 [26 U.S.C.A. § 1 et seq.], notwithstanding any other law of the United States, or of any State, territory, or the District of Columbia, no annuity or supplemental annuity shall be assignable or be subject to any tax or to garnishment, attachment, or other legal process under any circumstances whatsoever, nor shall the payment thereof be anticipated. 45 U.S.C. § 231m.
- Federal Retirement program benefits: An amount payable under subchapter II, IV, or V of this chapter is not assignable, either in law or equity, except under the provisions of section 8465 or 8467, or subject to execution, levy, attachment, garnishment or other legal process, except as otherwise may be provided by Federal laws. 5 U.S.C. § 8470.

These statutes apply as against all parties: creditors, judgment creditors, debt collectors, and banks.

Ms. H of New Jersey found out about a levy on her bank account when she was unable buy need medication because the bank had frozen both her savings and checking accounts in response to a garnishment order. Ms. H's sole source of income was Social Security. The garnishment was for an amount less than the New Jersey statutory $1,000 exemption. Ms. H's legal aid lawyer provided proof to the creditor's counsel that the funds were entirely from Social Security and therefore exempt from attachment. The creditor's attorney requested the bank release the funds. But the bank did not respond for more than a week. The Clerk of Court insisted that nothing could be done without cooperation from the bank. The state court procedure permitted an appeal to the court for an order releasing the levies, but the judge assigned to hear these appeals was away on vacation. Finally, after two weeks during which Ms. H was without her life supporting medication, the bank finally agreed to release Ms. H's funds. Case Supplied by Laurie E. Doran, South Jersey Legal Services, Atlantic City, NJ

The United States Supreme Court has repeatedly reiterated that Social Security[7] and Veterans Benefits[8] are protected from attachment and garnishment. The protections in these federal statutes explicitly apply to benefits that are "paid and payable," thus making the benefits exempt both before and after payment to the beneficiary,[9] regardless of whether the creditor is a state or a private entity.[10]

In *Porter v. Aetna Casualty and Surety Co.*,[11] the U.S. Supreme Court held that federally exempt disability benefits deposited in a bank account remained exempt so long as they are readily traceable and "retain the quality as moneys," – that is, they are readily available for the day-to-day needs of the recipient and have not been converted into a permanent investment.[12] This rationale has been widely applied to other exempt benefits, to hold that exempt funds remain exempt in checking,[13] savings,[14] or CD[15] accounts so long as these are "usual means

[7] *Bennett v. Arkansas*, 485 U.S. 395 (1988); *Philpott v. Essex Cty. Welfare Bd.*, 409 U.S. 413 (1973).

[8] *Porter v. Aetna Cas. & Surety Co.*, 370 U.S. 159 (1962) (holding that deposited VA benefits retain exempt status if they remain subject to demand and use for needs of recipient for maintenance and support and are not converted to permanent investment).

[9] *Philpott v. Essex Cty. Welfare Bd.,* 409 U.S. 413 (1973).

[10] *Bennett v. Arkansas*, 485 U.S. 395 (1988); *Philpott v. Essex Cty. Welfare Bd.*, 409 U.S. 41 (1973).

[11] *Porter v. Aetna Cas. & Surety Co.*, 370 U.S. 159 (1962).

[12] *See Porter v. Aetna Cas. & Surety Co.*, 370 U.S. 159 (1962). *See also Jones v. Goodson*, 772 S.W.2d 609 (Ark. 1989) (certificates of deposit purchased with veterans benefits remained exempt; funds were "immediately accessible" even though depositor would forfeit some interest in case of early withdrawal); *Younger v. Mitchell*, 777 P.2d 789 (Kan. 1989) (veterans benefits deposited into an interest bearing savings account exempt); *United Home Foods Dist., Inc. v. Villegas*, 724 P.2d 265 (Okla. Ct. App. 1986).

[13] *Porter v. Aetna Cas. & Surety Co.*, 370 U.S. 159 (1962); *S&S Diversified Servs. L.L.C. v. Taylor*, 897 F. Supp. 549 (D. Wyo. 1995); *United Home Foods Dist., Inc. v. Villegas*, 724 P.2d 265 (Okla. Ct. App. 1986).

[14] *Porter v. Aetna Cas. & Surety Co.*, 370 U.S. 159 (1962); *Younger v. Mitchell*, 777 P.2d 789 (Kan. 1989).

[15] *In re Smith,* 242 B.R. 427 (Bankr. E.D. Tenn. 1999) (proceeds of veteran's life insurance policy remained exempt when widow used them to purchase CD, and funds were not commingled with other funds); *Jones v. Goodson*, 772 S.W.2d 609 (Ark. 1989) (key issue was accessibility; depositor could obtain funds at will, although he would be penalized by loss of some interest); *Decker & Mattison Co. v. Wilson*, 44 P.3d 341 (Kan. 2002) (proceeds of workers'

of safekeeping" money used for daily living expenses.[16] Courts have consistently held that the rules used to employ exemptions designed to safeguard income and assets from judgment creditors must be liberally construed in favor of the debtor.[17]

B. The Policy: Exempt Benefits Must Be Protected.

To preserve these benefits for recipients, Congress provided that the benefits cannot be seized to pay pre-existing debts, as such seizures would result in the loss of subsistence funds. Each of the statutes governing the distribution of these funds specifically articulates that these funds are to be free from "attachment or garnishment or other legal process."

The courts have repeatedly articulated the underlying reasons for these protections:

(1) to provide the debtor with enough money to survive;
(2) to protect the debtor's dignity;
(3) to afford a means of financial rehabilitation;
(4) to protect the family from impoverishment; and
(5) to spread the burden of a debtor's support from society to his creditors.[18]

C. Seizures of Exempt Funds Violate Both the Law and the Policy.

Despite the explicitness of the federal law and the purpose of these benefits, banks routinely freeze accounts holding these benefits when they receive garnishment or attachment orders. When the account is frozen, no money is available to cover any expenses for food, rent, or medical care. Checks and debits previously drawn on the account (before the recipient learned that the account

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compensation settlement, deposited in couple's joint account, then used to purchase CD remained exempt, where funds were traceable and CD a usual means of safekeeping); *E.W. v. Hall*, 917 P.2d 854 (Kan. 1996). *But see Feliciano v. McClung*, 556 S.E.2d 807 (W.Va. 2001) (lump sum workers' compensation award would remain exempt in ordinary bank account, but purchase of CD turns it into non-exempt investment).

[16] *See Porter v. Aetna Cas. & Surety Co.*, 370 U.S. 159 (1962). *See also Jones v. Goodson*, 772 S.W.2d 609 (Ark. 1989) (certificates of deposit purchased with veterans benefits remained exempt; funds were "immediately accessible" even though depositor would forfeit some interest in case of early withdrawal); *Younger v. Mitchell*, 777 P.2d 789 (Kan. 1989) (veterans benefits deposited into an interest bearing savings account exempt); *United Home Foods Dist., Inc. v. Villegas*, 724 P.2d 265 (Okla. Ct. App. 1986) (veterans benefits direct deposited into a bank account and used to pay household expenses "clearly exempt").

[17] *See, e.g. Wilder v. Inter-Island Stream Navigation Co.*, 211 U.S. 239 (1908); *In re Perry*, 345 F.3d 303 (5th Cir. 2003) (Texas homestead law); *In re Colwell*, 196 F.3d 1225 (11th Cir. 1999) (Florida law); *In re Crockett*, 158 F.3d 332 (5th Cir. 1998) (Texas law); *In re McDaniel*, 70 F.3d 841 (5th Cir. 1995) (Texas law); *In re Johnson*, 880 F.2d 78, 83 (8th Cir. 1989) (Minn. law); *Tignor v. Parkinson*, 729 F.2d 977, 981 (4th Cir. 1984) (Va. law); *In re Carlson*, 303 B.R. 478 (B.A.P. 10th Cir. 2004) (Utah law); *In re Casserino*, 290 B.R. 735 (B.A.P. 9th Cir. 2003) (Oregon law); *In re Vigil*, 2003 WL 22024830 (10th Cir. Aug. 26, 2003) (Wyo. law); *In re Winters*, 2000 Bankr. LEXIS 648 (10th Cir. B.A.P. June 26, 2000); *In re Kwiecinski*, 245 B.R. 672 (10th Cir. B.A.P. 2000); *In re Bechtoldt*, 210 B.R. 599 (B.A.P. 10th Cir. 1997) (Wyo. law). *See generally* NATIONAL CONSUMER LAW CENTER, COLLECTION ACTIONS §12.2.1 (1st ed. 2008).

[18] *See, e.g.*, *In re Johnson*, 880 F.2d 78, 83 (8th Cir. 1989) (Minn. law); *North Side Bank v. Gentile*, 385 N.W.2d. 133 (1986); William T. Vukowich*, Debtors' Exemption Rights*, 62 GEO. L.J. 779, 787 (1974).

was frozen) are returned unpaid. Subsequent monthly deposits into the account will also be subject to the freeze and inaccessible to the recipient.

The funds will remain frozen for a time period determined by state law before being turned over to the creditor. In order to unfreeze the account, generally the recipients must find attorneys or go to the local court house on their own, fill out a form stating that the funds in the account are exempt, and then present the form and accompanying proof in the form of letters from Social Security and bank statements to the creditor. If the creditor voluntarily agrees to release the funds, the creditor will send a release of the attachment to the bank. At this point, it may still take several days or even weeks before the funds are actually released. In some jurisdictions, forms for this purpose are not available at local courthouses, and there is no established procedure for presenting this information to the creditor. Thus even in the best – and rare – case scenario, where the debtor is able to convince the creditor unfreeze the account voluntarily, it still often takes several weeks, and significant harm generally occurs.

Even when proof that the funds are exempt is presented to the creditor, if the creditor does not voluntarily agree to release the funds, the only way to have the bank account unfrozen is for the recipient to request a hearing. In most cases a lawyer is necessary to help a recipient through this arcane judicial process. Yet lawyers are hard to find in many areas. Legal aid programs are generally overwhelmed with other work. Transportation to lawyers, the courthouse and the bank is often difficult and expensive for recipients, who are by definition elderly or disabled and often impoverished.

To add insult to injury, quite often, after the recipient successfully proves that an attachment or garnishment order was wrongly applied against exempt funds, the judgment creditor sends another order, based on the same judgment.[19] This requires the recipient to repeat the process of showing that the funds are exempt. Because of the sheer number of difficulties involved (finding an attorney, going to the courthouse, filing papers, going through a hearing, waiting for the bank to released the funds), the recipient either gives up and allows the funds to be paid to satisfy the judgment, or drops out of the banking system, receiving future federal benefits by paper check.[20]

The effect of a freezing of exempt funds is thus generally a full taking of these funds, because rarely does the recipient have the wherewithal to pursue the process of claiming the exemptions.

D. The New Realities Require Clearer Prohibitions.

Three critical elements dictate a change in the legal response to attachment and garnishment orders applied against exempt funds in bank accounts:

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[19] *See, e.g. Mayers v. N.Y. Cmty. Bancorp Inc.*, 2005 WL 2105810 (E.D.N.Y. Aug. 31, 2005) (creditor hospital restrains disabled SSI recipients account three times); *Washington v. Gutman, Mintz, et al.*, 07 CIV. 4096 (EDNY 2008) (FDCPA claim against creditor who, over 22 months, restrained homeless woman's SSI account three times for the same debt).

[20] *See, e.g. Miceli v. Lincoln Financial*, 2007 WL 2917242 (N.Y.Dist.Ct. 2007)(finding "unequivocal proof" that taken moneys were exempt based on exact evidence the debtor gave the creditor out of court).

- Tens of millions of low-income recipients of federal benefits now have their payments directly deposited into bank accounts, where they had previously received paper checks. For example, in 1985, 41.5% of Social Security recipients and 12.4% of SSI recipients received their payments electronically. By 2010, these percentages have risen to 86.9% and 65.1% respectively.[21] Of these 47 million recipients receiving electronic payments, a substantial portion of this group are low income and rely exclusively or primarily on these payments to meet all their basic living needs.[22] These numbers have risen so dramatically because of the huge government effort to promote direct deposit fostered by the passage of EFT 99 in 1996, which requires that all federal payments (except income tax refunds) be electronically deposited.[23] Indeed, the numbers will increase even more dramatically in the future, as Treasury has announced that as of 2013 *all* government payments will be made electronically into bank accounts (or to debit cards).[24]

- The number of judgments *against* these impoverished recipients of federal benefits has escalated dramatically in recent years. As the credit industry continues to provide high priced credit to low-income recipients, and piles on astronomical late fees, over the limit fees, and exorbitant interest rates, the unpaid debts of these low-income recipients continue to mount. This higher and higher level of unpaid debt, in turn, creates a greater demand for access to these exempt funds that are intended to be sacrosanct and kept for the sole purpose of protecting the recipients from impoverishment.[25]

- Electronically deposited federal benefits are easily identifiable. In the past, the claim that it was burdensome for the banks to look first before applying an attachment made some sense. The funds were generally all deposited in a paper format and more intricate inquiry was required to determine the genesis of each deposit. Now, the situation is quite different. The ease of identifying electronically deposited federally exempt funds has been further facilitated by Treasury's plan to encode an "X" on the Batch Header Record for each federally exempt benefit deposited electronically through the Automated Clearing House (ACH).[26]

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[21] SOCIAL SECURITY, TRENDS IN DIRECT DEPOSIT PARTICIPATION (June 2010), *available at* http://www.ssa.gov/deposit/trendenv.shtml.

[22] 75 Fed. Reg. 20299, 20300 (April 19, 2010).

[23] 31 U.S.C. § 3332. *See also* 31 C.F.R. § 208.1.

[24] Ed O'Keefe, *Federal Benefits to be Paid Electronically by 2013*, WASH. POST, April 19, 2010, at http://www.washingtonpost.com/wp-dyn/content/article/2010/04/18/AR2010041803094.html.

[25] *See,* Loonin and Renuart, *The Life and Debt Cycle: the Growing Debt Burdens of Older Consumers*, 44 HARV. J. LEGIS. 167 (2007); COMMUNITY DEVELOPMENT PROJECT, URBAN JUSTICE CENTER, DEBT WEIGHT: THE CONSUMER CREDIT CRISIS IN NEW YORK CITY AND ITS IMPACT ON THE WORKING POOR (2007), *available at* http://www.urbanjustice.org/pdf/publications/CDP_Debt_Weight.pdf.

[26] 75 Fed. Reg. 20299, 20302 (April 19, 2010).

The claim that it is difficult or impossible for banks to determine whether there are exempt funds in an account before implementing a garnishment order is belied by the fact that *some banks currently identify electronically deposited exempt funds, and refuse attachment orders against those funds.*[27] Clearly, it is not difficult or illegal, nor expensive to perform this analysis first. The issue is whether the banks *should* look, not whether they can-- because they clearly can. The technology is simple: every electronic deposit is denominated by the source and type of funds. Treasury's new mechanism to identify electronically deposited exempt funds with a special numerical code will make this process of identification even simpler for banks.[28]

E. Commingling of Funds Should Not Stop Protection of Exempt Funds.

When the funds in a bank account subject to garnishment are all electronically deposited and are all exempt funds, there is little justification for a bank's seizure of those unquestionably exempt funds for a garnishment order.[29] If the only deposits in the account are unambiguously exempt funds, the order should be returned unsatisfied. The complexity arises when the exempt funds are commingled with non-exempt funds.

Commingling exempt funds with non-exempt funds appears to be the norm, rather than the exception, either with non-exempt funds owned by the recipient, or with funds of another person who is not a debtor on the attachment or garnishment.[30]

While commingling of exempt funds with non-exempt funds or funds of another raises the problem of traceability, in the context of garnishment or attachment proceedings, these issues are generally

[27] In New York, even before the passage of New York's Exempt Income Protection Act, 628.2 N.Y. C.P.L.R. 5205 (McKinney), the new law protecting exempt funds from garnishment, several banks indicated to Johnson Tyler, attorney for low-income recipients of federal benefits from South Brooklyn Legal Services, that they routinely refused to garnish electronically deposited federally exempt funds. These banks included New York Community Bank, Rosslyn Savings Bank, JP Morgan Chase and Household Bank. More recently, reports have come in that Wells Fargo Bank is refusing to garnish exempt funds electronically deposited (per Galen Robinson, Mid-Minnesota Legal Services).

[28] 75 Fed. Reg. 20299, 20302 (April 19, 2010).

[29] Before electronic deposit of federally exempt funds was commonplace, and pursuant to the required balancing test dictated by the seminal Supreme Court case of *Mathews v. Eldridge,* 424 U.S. 319 (1976), the courts had allowed the temporary freezing at issue here. But in the past few years, courts have been recognizing that the technological changes that make it so easy to identify the funds as exempt, when weighed against the terrible harm caused to recipients by the attachment of exempt funds, may necessitate a different constitutional response. *See, e.g. Granger v. Harris*, 2007 WL 1213416 (E.D.N.Y. Apr 17, 2007) (recipient stated § 1983 claim against bank that disbursed funds to creditor, despite knowledge that funds were Social Security; state statute imposing sanctions on bank that failed to comply with restraining order was state compulsion sufficient to allege action under color of state law); *Mayers v. New York Cmty. Bancorp, Inc.*, 2005 WL 2105810 (E.D.N.Y. Aug. 31, 2005) (refusing to dismiss due process claim against banks and others for failing to protect Social Security benefits in bank account from garnishment order), later decision, 2006 WL 2013734 (E.D.N.Y. July 18, 2006) (denying defendants' motion for interlocutory appeal). The courts in these cases have reached this preliminary conclusion based only on the constitutional balancing tests between the interests of the parties.

[30] An official from the FDIC has estimated that as many as 80% of bank accounts into which exempt Social Security and SSI funds are deposited are commingled with non-exempt funds. *Meeting between federal banking regulators and consumer advocates*, March 18, 2008, Washington, D.C.

resolved in a court of law. The majority rule across the United States is that exempt funds will continue to be protected even when deposited into accounts with non-exempt funds,[31] generally applying a first-in first-out accounting method.[32] A small minority of courts have refused to require tracing, finding that the exemption was lost when the funds were commingled.[33]

If the commingled exempt funds must be sorted out by a court, then the bank as garnishee has no choice except to freeze the entire amount in the debtor's account. As explained above, because of the difficulties in obtaining a lawyer, scheduling hearings, and going to court, the immediate seizure effectively means a final taking for most low-income recipients. So kicking the issue of divvying up commingled funds to a court does not resolve the problem – it only exacerbates it. The question on the table has been whether there is an appropriate and non-burdensome way *for banks* to determine which of commingled funds are exempt *before* the seizure.

F. Commingled Exempt Funds Can Be Protected from Seizure.

To address the need to create a rule for banks to know which funds in commingled accounts are to be preserved from freezing pursuant to a garnishment order, several states have used the set amount method. For many years the state of California has required that a set amount be considered to be exempt from all attachments, and only the funds in the account that exceed that amount are available for seizure.[34] In 2008, New York[35] adopted a law that provides that, if reasonably identifiable statutorily exempt funds have been electronically or directly deposited

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[31] *Tom v. First Am. Credit Union*, 151 F.3d 1289 (10th Cir. 1998); *Granger v. Harris*, 2007 WL 1213416 (E.D.N.Y. Apr 17, 2007) (noting that exempt benefits do not lose their exempt status even when commingled.); *In re Nye*, 210 B.R. 857 (D. Colo. 1997); *In re Williams*, 171 B.R. 451 (D.N.H. 1994); *NCNB Fin. Servs. v. Shumate*, 829 F. Supp. 178 (W.D. Va. 1993), *aff'd without op.*, 45 F.3d 427 (4th Cir. 1994); *In re Sanderson*, 283 B.R. 595 (Bankr. M.D. Fla. 2002) (recently amended Fla. Stat. § 222.25 exempts tax refunds attributable to earned income credit, even after deposit and commingling); *In re Mix*, 244 B.R. 877 (Bankr. S.D. Fla. 2000) (workers' compensation settlement remains exempt when deposited in checking account, even if commingled with non-exempt funds, so long as traceable); In re Lazin, 217 B.R. 332 (Bankr. M.D. Fla. 1998); In re Meyer, 211 B.R. 203 (Bankr. E.D. Va. 1997) (noting statutory protection for unemployment benefits and workers' compensation benefits even if deposited and commingled); *In re Ryzner*, 208 B.R. 568 (Bankr. M.D. Fla. 1997); *In re Norris*, 203 B.R. 463 (Bankr. D. Nev. 1996); *Waggoner v. Game Sales Co.*, 702 S.W.2d 808 (Ark. 1986); *Broward v. Jacksonville Med. Ctr.*, 690 So. 2d 589 (Fla. 1997); *Parl v. Parl*, 699 So. 2d 765 (Fla. Dist. Ct. App. 1997); *Beardsley v. Admiral Ins. Co.*, 647 So. 2d 327 (Fla. Dist. Ct. App. 1994); *Decker & Mattison Co. v. Wilson*, 44 P.3d 341 (Kan. 2002) (proceeds of workers' compensation settlement, deposited in couple's joint account, then used to purchase CD remained exempt, where funds were traceable and CD a usual means of safekeeping); *Hatfield v. Christopher*, 841 S.W.2d 761 (Mo. Ct. App. 1992); *Collins, Webster & Rouse v. Coleman*, 776 S.W.2d 930 (Mo. Ct. App. 1989); *Dean v. Fred's Towing*, 801 P.2d 579 (Mont. 1990).

[32] *See, e.g., S&S Diversified Servs. L.L.C. v. Taylor*, 897 F. Supp. 549 (D. Wyo. 1995); *NCNB Fin. Servs. v. Shumate*, 829 F. Supp. 178 (W.D. Va. 1993), *aff'd without op.*, 45 F.3d 427 (4th Cir. 1994); *Dean v. Fred's Towing*, 801 P.2d 579 (Mont. 1990).

[33] *See, e.g.,* Bernardini v. Central Bank, 290 S.E.2d 863 (Va. 1982). *See also* Idaho Code § 11-604 (exemptions for insurance, disability and family support are "lost immediately upon the commingling of any of the funds . . . with any other funds").

[34] *See, e.g.* West's Ann.Cal.C.C.P. § 704.080.

[35] 628.2 N.Y. C.P.L.R. 5205 (McKinney).

within forty-five days preceding the service of a restraining notice, $2500 in the debtor's account is exempt.[36] Pennsylvania rules of civil procedure state explicitly that service of the writ will not attach funds in an account in which funds are direct-deposited on a recurring basis and identified as exempt under state or federal law.[37]

But in this proposed rule, Treasury has proposed an even simpler and clearer formula. The regulations direct banks to determine whether there are exempt funds to be protected from freezing to satisfy the garnishment order simply by adding together all the benefits payments (as defined by the rule) electronically deposited into the account during the lookback period.[38] The "protected amount" is the lesser of this sum or the balance in the account on the date of the account review. (Proposed 31 CFR § 212.3). To provide a name for this method of delineating exempt funds from non-exempt funds, we might name it "Sum Up – Last Out."

Regardless of whether non-exempt funds have been deposited in the account, or whether there have been any withdrawals, this method is simple – it only requires simple addition – and clear – there can be little confusion from applying this sum. Conceptually the method recommended by Treasury makes perfect sense. The idea behind the protections established by Congress for these benefits is to ensure that the funds should be available to meet the necessities of the recipient. This method of determining exempt funds ensures that the benefits are considered to be the last spent in the account, the most protected.

Ethel Silmon is a 59 year old widow whose only income was Social Security Disability of $889 per month. She has been on disability for several years due to severe anxiety, depression, COPD, and a heart condition. She had a credit card for years and paid regularly until she became disabled and could no longer work. As her income had dropped dramatically she defaulted on the debt. The debt buyer sued her and got a judgment against her for $13,474. They started harassing her to collect the judgment. Her Legal Aid attorney told her that she was judgment proof and that her income was protected. Her attorney also helped her submit a letter to her bank (Wachovia) about her exempt status. They also sent a letter to the debt collector explaining that Mrs. Silmon's only income was exempt from judgments. Despite the letters, after obtaining a judgment, the debt collector filed a Writ of Seizure against Mrs. Stilmon's bank account held by Wachovia. The bank promptly froze her bank account. The writ was for $15,895.44 and the bank informed Mrs. Silmon and her attorney that they would not release the funds in the client's bank account until the full amount was collected or they received a court order dismissing the writ. At the time, Mrs. Silmon had less than $1,000 in the bank and she had written checks for her mortgage, electricity, medical expenses, and groceries that the bank refused to honor. The bank also charged Mrs. Silmon overdraft fees on each of the checks she had written. The bank resisted all voluntary efforts to resolve the matter. Almost a month after the funds were frozen the funds were finally released. During the month without access to her money, Mrs. Silmon suffered severe anxiety attacks, she had to go to the food bank for food, and had to rely on her doctors for samples of medicine. She is still fearful that they will try it again and states that she can not handle it if they do. Case supplied by: Tracie Melvin, Legal Services of Alabama, Montgomery, AL.

The "Sum Up-Last Out" method of accounting should be recommended by Treasury as the appropriate method for courts to use in any determination in which federally exempt funds are

[36] The amount of this exemption is to be adjusted for inflation every three years, starting in 2012.

[37] PA. R. CIV. P. 3111.1.

[38] The proposed rule defines the lookback period as 60 days. Proposed 31 CFR § 212.3. In this comment, we propose that the lookback period be extended to 65 days. *See infra,* § II, B.

delineated when there has been commingling. When a court is applying the method, there is no hurry, and all of the available bank records will be examined, so there need be no limited "lookback period." A judicial determination of the federally exempt funds will look at all the deposits back to the first relevant one.

Recommendation: **Treasury should mandate that in every situation in which federally exempt funds have been commingled, Treasury's simple accounting rule of "Sum Up-Last Out" be applied. When courts are applying this method, there need be no limit on the lookback period.**

G. Requiring Banks to Determine the Protected Amount is an Appropriate Way of Dealing with Inconsistent State Laws.

The federal law on the exempt status of the payments to recipients is absolutely clear. State law cannot change that exempt status. However, because state laws on exemptions and garnishments are inconsistent and not always clear, there is a need for a federal authority to direct the determination of how federally exempt funds should be protected. Some states clearly articulate that money that is exempt under federal law is also exempt from garnishment under state law.[39] Other state laws do not clearly establish this point.

State laws cannot cause federally exempt funds to lose their status as exempt. Yet, state laws on exemptions, garnishment and attachment do not always include the procedures necessary to properly protect freezing funds that are exempt under federal law. The problem has been that although those funds are unquestionably exempt, until now – with the publication of this proposed rule – there has not been a clearly delineated procedure for banks to follow to make this determination.

Some states provide a method to identify exempt property prior to seizure, while others only provide that the consumer can go to court after the seizure to obtain the return or release of the property.[40] In many states, the exemptions allowed under state law must be affirmatively asserted to be preserved.[41] There is a critical distinction between property which is exempt under state law and that which exempt under federal law. If federal law specifies that property is exempt, a state law cannot properly be interpreted to have the effect of denying the recipient that exemption because of the recipient's failure to follow the state law.

Banks often argue that they perceive a risk of liability or sanctions if they disburse funds subject to a garnishment order to debtors. In actuality, it seems highly unlikely that a bank would be sanctioned for refusing to freeze funds that are unequivocally exempt under federal law. We do agree,

[39] *See* NATIONAL CONSUMER LAW CENTER, COLLECTION ACTIONS, *Appendix F*, *Summaries of State Exemption Laws* (2008).

[40] *Id.*

[41] *Id.*

however, that especially when funds have been commingled, that the determination of exempt funds can be messy.

It is very important not to create the incentive for Social Security and other beneficiaries to have second class bank accounts – as would happen if by depositing one dollar of non-exempt funds the recipient would lose any protections applied to accounts comprised purely of exempt funds. It would be an odd national policy to punish the normal use of bank accounts by recipients when they deposit other funds in their accounts, when one of the stated reasons for EFT 99 was to encourage the use of mainstream banking by low-income federal recipients.[42]

The proposed rule by Treasury and the other federal agencies to protect federally exempt funds from seizure by creditors is an essential mechanism to protect beneficiaries from inappropriate and illegal garnishments and to ensure the purposes of these federal payments are achieved.

II. Specific Section Analysis – Support and Suggestions for Clarification

A. The Proposed Rule is Excellent in Many Ways.

We heartily applaud and endorse the simple clear methodology proposed. Generally, we support the entire structure and most of the details specified in the proposed rule. We are particularly supportive of the following essential elements of the proposed rule:

1) *The fact that the rule will be required to be applied to every garnishment received by every bank in every state (212.5(a)).* With the correction recommended below to the number of days in the lookback period (see section II, B, 1 below), this uniform application of the simple rule will ensure that at least two months Social Security and other exempt federal benefits will be protected from seizure to satisfy judgment creditors.

2) *The requirement that banks apply the lookback analysis and the protected amount protection to every account against which a garnishment order has been issued (212.5 (a) and (f)).* This uniform application to every account is much better than setting and applying a maximum amount to be protected (as is done in the California and New York regimes). If a judgment debtor's name is on an account, it is subject to the garnishment order. Yet, in states that use the static amount as the protected amount, often the result is that the funds in only one account is protected. We do have some recommendations regarding protecting the total sum of exempt funds deposited during the lookback period, rather than only those specifically in the account into which they were deposited in section II, B, 1, b, below.

3) *The determination of the protected amount as the sum of all benefit payments deposited during the lookback period (up to the balance in the account when the review is taking place) regardless of the deposit of other, non-exempt funds, and regardless of withdrawals*. (212.3 and 212.5(c), (d) and (f)). This protection is brilliant and is the key ingredient to the success of this proposed rule. It will ensure that millions of

[42] *See* 142 CONG. REC. H48721 (1996).

dollars of federal benefits will be used for their intended purpose – to support the basic needs of the recipients – rather than transferring these funds over to judgment creditors.

4) *The requirement that the bank is required to review the account for exempt benefits before it takes any other action in relation to the garnishment order (212.5(e)).* This requirement ensures that the procedure will accomplish the purpose of the rule. Without this part of the rule, banks could freeze funds first, and then evaluate whether there are exempt funds to be protected in the account.

5) *The preemption of those state laws which extend the garnishment order past one day, so that the protections provided by this rule will effectively preserve the exempt benefits (at least those within the protected amount) for the use by the recipient (212.6(d) and (e) and 212.9(a)).* This will alleviate the problems occurring in New York State where the banks are only required to apply the statutory protection of exempt funds on one day, but the garnishment order applies for a year. The effect of this uneven protection has been that only those funds deposited on the day the garnishment order is served are protected. However, in New York, exempt funds deposited the next day, or the next month are not protected and remain subject to the garnishment order. Instead of allowing these difficulties this proposed rule will ensure that account balances up to the sum of the exempt funds deposited within the two-month lookback period will be protected from seizure and garnishment.

Anne D., 45, a Pilates instructor who suffers from mental illness and lives in Manhattan, discovered that her bank account, which contained only exempt funds, was frozen when she attempted to withdraw cash from an ATM last October. The victim of identity theft, Ms. D. was never served with a summons and complaint or a restraining notice, and did not know a default judgment had been entered against her in another county. While her account was frozen, Ms. D. could not pay her rent, buy food, or purchase medicine. In addition, her bank charged her fees for returned checks. Although a bank manager helped Ms. D. contact the plaintiff's attorney and even informed the attorney that Ms. D.'s account contained only exempt funds, the bank said it could not violate the restraining order by lifting the restraint on its own. The account remained frozen until Ms. D. successfully vacated the default judgment several weeks later. The funds in Ms. D.'s accounts at that time consisted only of Supplemental Security Income (SSI), and earned income, which is exempt from collection, pursuant to N.Y. Social Services Law § 137-a. Case supplied by: Carolyn E. Coffey, MFY Legal Services, New York, NY.

6) The ability of states to pass laws which provide greater protections for recipients. The provision in Section 212.9(b) that explicitly preserves state laws that provide greater protection than is achieved by this rule is very important. Several states have adopted – by statute or rule – protections which provide in some instances greater protections than in this rule.[43] The state rules and this regulation will have to be read together to provide the highest level of protection.

For example, in Pennsylvania, the rule is that there is no freezing of any funds up to $10,000 in an account in which exempt funds have been deposited.[44] But creditors are permitted to go to court

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[43] *See, e.g.,* California – West's Ann.Cal.C.C.P. § 704.080; Connecticut – General Statutes 52- 367b (amended 2002); New York – 628.2 N.Y. C.P.L.R. 5205 (McKinney); Pennsylvania – Civil Procedure Rule 3111.1 (effective April 7, 2007); District of Columbia – Code § 16-552 (amended 2008); Michigan – Court Rule 3.101.(I)(6)(effective September 1, 2009); Alabama – Unified Judicial System, Form C-21 Rev. 11/06 ("Process of Garnishment") (effective November 2006), Cook County, Illinois – Form CCM 0124 ("Citation to Discover Assets to a Third Party", Revised June 30, 2008).

[44] PA. R. CIV. P. 3111.1.

and challenge whether all of the funds in the account are in fact exempt. The coordination of this state rule along with the federal regulation will require that in Pennsylvania the banks will determine which funds are protected under this regulation's lookback period, but will not be permitted to freeze any funds in these accounts unless there is more than $10,000. In Pennsylvania the protected amount (all the federal funds deposited during the lookback period, regardless of other deposits and withdrawals) will be absolutely protected, just as in other states. The difference is that in Pennsylvania the funds over the protected amount in the account, up to $10,000 will also be protected, but the creditor can challenge the exempt status of the additional funds, *over* the protected amount.

7) *The requirement that the bank send a notice to the recipient about the garnishment, the exemptions, the protected amount, and the recipient's rights to protect exempt funds not included in the protected amount, information sufficient to identify the creditor and the court and the bank (212.7).* This protection – like the others – is critical. Many consumers never receive the notice from the judgment creditor, and only find out about the garnishment after their funds have been seized, their checks have bounced, and numerous overdraft fees have been incurred. It is also extremely helpful that this notice will provide information about other – state – exemptions which might be applicable to the funds in the account which have been frozen. We do have some recommendations about additional information to be included, see section II, B, 5 below.

8) *The prohibition against the bank taking a garnishment fee from the protected amount (212.6(g)).* Federally exempt funds should be unequivocally protected from not only the garnishments by judgment creditors, but also from bank fees. Suggestions on clarifying this to ensure that banks are not permitted to take a garnishment fee from the protected amount are in section II, B, 4 below.

9) *The limitation of the exemptions to this rule to orders issued by the United States (212.4), and the fact that this exemption does* not *include orders issued for child support.* As Treasury has noted in the Supplementary Information to the proposed rule that financial institutions will not be responsible for determining the purpose of the garnishment order, including whether the order seeks to collect child support or alimony obligations. As there is a clear and simple way for collections of these judgments to be processed directly through the agencies,[45] there is no need to complicate and undermine the simplicity of the protections provided in this rule. To the extent that there have been problems in the past with agency processing of child support orders, Treasury will surely work to mitigate these issues in the future. These past problems should not be the basis to change this rule, as these can be readily resolved.

B. Areas Needing Improvement.

The federal agencies promulgating this rule have stated that "[t]he Agencies are proposing to adopt a rule that would set forth straightforward, uniform procedures for financial institutions to follow in order to minimize the hardships encountered by Federal benefit payment recipients whose accounts

[45] *See* 75 Fed. Reg. 20301, 20303 n.11 (Apr. 19, 2010) (citing 5 CFR part 581). *See also* 20 CFR 404.1820; SSA Program Operations Manual System, GN 02410.200-.210; 20 CFR part 350; and VA Veterans Benefits Administration Manual Rewrite, M21-1MR, part III, subpart v, chapter 3, section C.13.

are frozen pursuant to a garnishment order."[46] To achieve this laudable purpose and to clarify the proposed rule, the following changes and clarifications and are necessary:

1. Section 212.3 Definitions:

a. Lookback Period – The lookback period needs to be extended from 60 to 65 days. The Background material to the proposed rule indicates that the protection provided by the rule is intended to preserve two cycles of payments.[47] The problem is that most 60 day lookback periods will not reach back to protect two full months of payments. This is caused by two factors: first, seven months out of the year have 31 days; and, second, when benefit payments are due on a day which falls on a weekend or holiday, the payment is actually deposited the business day *before* the due date. The effect of these would cause many situations in which the 60 day lookback period will only protect one payment cycle. Some examples include:

- Assume a payment is due on January 1, 2012, which falls on a Monday. As January 1 is a holiday, the payment would be made the previous Friday, December 29, 2011. If a garnishment order is served on March 1, the payment made on March 1 will not be protected because the lookback period starts the day *before* the garnishment order is served (February 28). But 60 days before February 28 is December 30, so the payment made on December 29th will not be protected. The rule would need to cover 61 days to protect two cycles in this example.

- Assume a payment is due to be made on July 4, 2011, which falls on a Monday. The payment will then have been made on the previous Friday, which was July 1. If a garnishment order is served on September 4, the September payment would not be protected because it would be made on September 4, *after* the lookback period ends. The August payment will be protected, but the July payment will not be because July 1 is 65 days before September 4. In this example, the lookback period would need to be 65 days to protect two monthly payments.

Recommendation: The definition of the "Lookback period" in Section 212.3 should be changed from 60 days to 65 days.

b. Protected Amount. Some recipients typically transfer small amounts of their Social Security or other income to a savings account to save up for large energy bills or to pay for expensive medicines. Those funds should be protected as well. And this can be easily accomplished by defining the protected amount as the sum of all federally exempt funds electronically deposited during the lookback period in any account owned by the account holder.

This protection would work in the following way:

[46] 75 Fed. Reg. 20299, 20300 (April 19, 2010).

[47] The intent of the lookback period is that the "last two cycles of benefit payments under any of the Agencies' programs are generally covered." 75 Fed. Reg. 20301, 20303 (Apr. 19, 2010).

Assume that Ms. H has $950 deposited in Social Security funds on the 4th of each month into her checking account and that soon after each deposit she transfers $50 into her savings account. By the end of each month, only $30 or $40 is regularly available in the checking account. But in some months, her savings account might have several hundred dollars in it – saved for larger household expenses such as insurance bill or to pay the end of winter heating bill. In this example, by the end of June, her savings account holds $350.

If the garnishment comes in on June 26, under the current formulation of the rule, the lookback period would only capture the sum of the deposits in the checking account, which would likely only be $30 or $40. But because no funds were directly deposited into her savings account, the entire amount of that account – even if it was comprised totally of exempt funds – would be seized and subsequently sent to the creditor.

However, if the rule were tweaked just a little bit, the protected amount would be defined as the sum of all electronically deposited federally exempt funds found in *any* account owned by the account holder, up to the balance of *all* accounts.

So in this example, the protected amount would be the lesser of ($950 plus $950) $1900, or the sum of the amount deposited in all of Ms. H's account. Ms. H's checking account holds $30 and her savings account holds $350, so $380 would be considered the protected amount if the aggregation method were applied.

This formulation is quite easy for the banks to accomplish – it simply requires the aggregation of the deposits held by the recipient in all accounts. Banks do this anyway on most bank statements. As simple as this new definition would be to accomplish it would nevertheless accomplish a tremendous amount of good: protecting the last funds of many of our more cautious low-income recipients – the savers.

Recommendation: The definition of "protected amount" should be changed as follows (new language in **bold).** As changes to Section 212.6(a) are also necessary, the changes to that section are proposed in the discussion of the issues relating to that section.

> **Sec. 212.3 Definitions.**
> "Protected amount" is defined as the lesser of (i) the sum of all benefit payments deposited **in**to **all of** the account**s owned by the account holder** during the lookback period or (ii) the balance in **these** ~~an~~ account**s** on the date of account review. Under this definition, there would not be a protected amount if the account balance**s** ~~is~~ **are** zero or the account**s** ~~is~~ **are** overdrawn.

2. Section 212.5 – Garnishments are Issued Against the Account "Holder" not a particular "Account."

Garnishment and attachment orders are issued against the assets owned by a person. The accounts owned by the person are not named in the garnishment or attachment order. The language of the proposed rule needs to be tweaked to clarify that it is not a particular account that is the target of the collection action, but all of the assets held by the debtor. Further, to accomplish the purpose of the rule, and explained in the section above, the protected amount should be evaluated based on the aggregated balance in all of the recipient's accounts, rather than simply the one in which the electronic deposit was made.

Section 212.5 needs be minor changes throughout to address both of these issues.

Recommendation: The language of Section 212.5 needs word-smithing as follows to clarify that the garnishment and attachment orders are issued against the account *holder* not a particular account, and to further the goal of defining the "protected amount" as the aggregate of the exempt funds in all of the recipient's accounts, rather than just one account (new language is in **bold**.)

Sec. 212.5 Account review.

(a) *Review for benefit payment*. No later than one business day following receipt of a garnishment order issued against an account **holder**, a financial institution shall perform an account review **on all of the accounts owned by the account holder**.

(b) *No benefit payment deposited during lookback period*. If the account review shows that a benefit agency did not deposit a benefit payment into **any of** the accounts **owned by the account holder** during the lookback period, then the financial institution shall follow its otherwise customary procedures for handling the garnishment order and shall not follow the procedures in § 212.6.

(c) *Benefit payment deposited during lookback period*. If the account review shows that a benefit agency deposited a benefit payment into ~~the~~ **any** account **owned by the account holder** during the lookback period, then the financial institution shall follow the procedures in § 212.6.

(d) *Uniform application of account review*. The financial institution shall perform a~~n~~ **review of each** account ~~review~~ without consideration for any other attributes of the account or the garnishment order, including but not limited to:

(1) The presence of other funds, from whatever source, that may be commingled in the account with funds from a benefit payment;

(2) The existence of a co-owner on the account;

(3) The existence of benefit payments to multiple beneficiaries, and/or under multiple programs, deposited in the account;

(4) The balance in the account, provided the balance is above zero dollars on the date of account review;

(5) Instructions to the contrary in the garnishment order; or

(6) The nature of the debt or obligation underlying the garnishment order, including whether the order seeks to collect alimony or child support obligations.

(e) *Priority of Account Review*. The financial institution shall perform the account review prior to taking any other actions related to the garnishment order that may affect funds in the account **holder's accounts**.

(f) *Separate account reviews*. The financial institution shall perform the account review separately for each account in the name of an account holder against whom a garnishment order has been issued.

3. Section 212.6(a) – Protecting the "*Protected Amount*."

As stated above, the formulation for the "protected amount" in the proposed regulation is excellent. However, to ensure that the entire purpose of the rule is not undermined, three important clarifications must be made.

a. Clarifying that the Protected Amount cannot be challenged. The rule implies throughout that the exempt funds within the "protected amount" are to be sacrosanct and non-challengeable by judgment creditors.[48] But it does not explicitly state that the protected amount shall conclusively be considered to contain only funds which are exempt under federal law. Without such an explicit pronouncement, judgment creditors may still file objections to the protected amount and try to litigate the issue of whether the protected amount includes non-exempt funds. Allowing this would completely defeat the purposes of this proposed rule. As Treasury has pointed out, most recipients of federal benefits are elderly or disabled. If the judgment creditor challenges the exempt status of the protected amount, the recipient will – in most cases – need a lawyer to navigate through the arcane post-judgment judicial process. Lawyers are hard to find in many areas of the nation and unless legal aid is available, they are expensive. Legal aid programs are generally overwhelmed with other work.

As Treasury stated: "If their accounts are frozen, these individuals may find themselves without access to the funds in their account unless and until they contest the garnishment order in court, a process that can be confusing, protracted and expensive."[49] Allowing creditors to challenge the exempt status of funds within the protected amount would defeat the purpose of the rule. It would permit judgment creditors to obtain access to exempt funds simply by pursuing litigation which in most instances recipients will not have the resources to defend.[50]

b. Protecting all exempt funds deposited during the lookback period into the recipient's accounts. As explained in the discussion above (in section II, B, 1, b) regarding the definition of the protected amount, the protected amount needs to include the sum of all federal exempt funds electronically deposited during the lookback period in any account owned by the account holder.

To accomplish this changed meaning, our proposed changes to the language of Section 212.6(a) are included below, after discussion of the next issue regarding the protected amount.

c. Clarifying that "access" to the protected amount means full and customary access. In New York State, after passage of the law protecting exempt funds in bank accounts,

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[48] "To address the foregoing problems the Agencies are proposing to adopt a new rule. The primary goals of the proposed rule are (1) to ensure that benefit recipients have access to exempt funds while garnishment orders are complied with, adjudicated, or otherwise resolved; . . ." 75 Fed. Reg. 20299, 20301 (April 19, 2010).

[49] *Id.* at 20300.

[50] *See Frozen Out: A Review of Bank Treatment of Social Security Benefits: Hearings Before the S. Comm. on Finance,* 110th Cong. 4 (2007), *available at* http://www.nclc.org/issues/banking/content/Testimony_Frozen_Out.pdf (testimony of Margot Saunders, National Consumer Law Center).

some banks have complied with the letter but not the spirit of the law. After the service of a garnishment order on an account which includes exempt funds, banks have been bouncing checks and denying ATM transfers. Some banks close the debtors' accounts, and only make the exempt funds available at one bank branch. This type of activity should be explicitly prohibited in the final rule. Allowing it will not only undermine the purpose of the rule – to protect federally exempt benefits from judgment creditors – but will also undermine Treasury's goal of encouraging more direct deposit of federal payments by continuing to allow second class treatment to recipients who are subject to garnishment orders.

Recommendation – To accomplish the necessary clarifications, as well as the change to the way the protected amount would be determined, the following changes – **in bold** – should be made to 212.6(a):

> "(a) *Protected amount*. The financial institution shall immediately calculate and establish the protected amount for **all of the accounts owned by the account holder** ~~an account~~. The financial institution shall ensure that the account holder has **full, unfettered and customary** access to the protected amount, which the financial institution shall not freeze in response to the garnishment order. An account holder shall have no requirement to assert any right of garnishment exemption prior to accessing the protected amount **and the protected amount shall be conclusively considered to be exempt under state and federal law**."

4. Section 212.6(f) – Clarifying legality of garnishment fee. This subsection states that the financial institution may take a garnishment fee from the funds in the account which are in excess of the protected amount. We agree with that statement, *unless* the funds above the protected amount are also exempt – as might happen if they were deposited before the lookback period.

The language in section 212.6(f) might be interpreted as support for financial institutions taking fees from exempt funds that do not fall within the protected amount. This provision also conflicts with the principle articulated in section 212.8(a) that nothing in the rule should limit the recipient's rights to assert the exempt status of funds in excess of the protected amount.

Allowing banks to collect garnishment fees against exempt funds is contrary to the purpose for which Social Security benefits are intended. It also makes no sense. As the courts have repeatedly recognized when interpreting a bank's use of its contractual right of set-off to seize exempt funds, it does not make sense to prohibit a third party from accessing the exempt funds, but allow a bank to seize the same funds it holds on deposit for its own purposes.[51]

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[51] *See, e.g., Tom v. First Am. Credit Union*, 151 F.3d 1289 (10th Cir. 1998) (noting that there is no relevant difference between set-off and garnishment); *Hambrick v. First Security Bank*, 336 F. Supp. 2d 890 (E.D. Ark. 2004) (Social Security's anti-assignment provision prohibited application of bank's set-off provisions in bank customer's agreements with bank); *Marengo v. First Massachusetts Bank, N.A.,* 152 F. Supp. 2d 92 (D. Mass. 2001) (Bank's set-off against Social Security funds violated Social Security Act); *In re Brewer,* 2002 WL 32917680 (Bkrtcy. S.D. Ill., Aug. 15, 2002) (42 U.S.C. § 407(a) prohibits Credit Union from taking Debtor's Social Security funds regardless of the prior agreement of the Debtors that the subject funds would act as collateral for their loans from the Credit Union).

In the context of *this* rule, this issue should be resolved so that the bank would be permitted to take a garnishment fee from funds in the account which are above the protected amount. However, if an account holder pursues the state law procedure to claim some or all of the frozen amount as exempt, and thus not subject to the garnishment, the bank would be required to release the garnishment fee it took from these funds as well.

Subsection 212.6(f) is unnecessary and confusing. Subsection (g) already states that financial institutions may not assess garnishment fees from the protected amount. Section 212.8(a) clarifies that funds in excess of the protected amount may nevertheless be exempt. Subsection 212.6(f) is unnecessary and could be used to justify the collection of the garnishment fee from exempt funds.

<u>*Recommendation* – Section 212.6(f) should simply be deleted</u>.

5. <u>Section 212.7 – Additional Information to be included in the Notice.</u> There will be many instances in which recipients have funds which are exempt under state law, or which were deposited prior to the lookback period, that will not be included in the protected amount. To protect these frozen funds from the garnishment, the recipient will generally have to find an attorney and go to court.

<u>*Recommendation* – The requirement for the notice that the banks are required to send to account holders should include the following:</u>

a) The Notice should specify exactly how much money the bank has frozen and the name and number of the account in which these funds were found. This information is necessary so that the recipient knows how to deal with paying future bills and potential bounced checks already drawn on the funds which have just been frozen.

b) The Notice should specify the amount of the garnishment fee the bank has assessed against the recipient's account, if any. This information is necessary so that the recipient will have the basis to understand the current balance in the account.

c) The Notice should state that future funds deposited in the account will *not* be subject to seizure as the result of *this* garnishment order.

Ms. F is a 43-year-old resident of Wilkes County, Georgia who receives Social Security disability after an accident severely damaged her legs. In 2006 a credit card company filed a garnishment against her accounts at Regions Bank. The garnishment summons instructed Regions Bank to immediately hold all property belonging to Ms. F "except what is exempt." Although her only income was electronically deposited Social Security income, Regions Bank froze her account, withdrew $807.57 for the garnishment and then an additional $75 for a garnishment fee. The checks Ms. F had previously written all bounced, and Regions Bank charged Ms. F an additional $217 in NSF fees.
Ms. F learned about the garnishment a week later when she attempted to make a withdrawal. She explained to the branch employees that her account only had electronically deposited Social Security funds in. A lawyer then wrote a letter to the bank stating that Social Security is exempt. Despite the letter, the bank asserted the account was subject to garnishment and sent the money to the clerk, who forwarded it to the creditor. After a month, Ms. F's Social Security funds were finally released.
The garnishment caused Ms. F significant stress as she could not afford to fill her prescriptions for Nexium and Celebrex. Her inability to take these medicines, and her lack of money for food, combined with the stress caused by the garnishment, caused her to lose approximately fifteen pounds that month. Case submitted by Patrick Cates, Georgia Legal Services Program, Gainesville, Georgia.

d) The notice needs to include information about local, free, legal services programs.[52]

e) While it is helpful for the Appendices to the regulation to include a sample notice, it would be better for the regulation itself to reference and specifically recommend the use of the model notice with blanks to be filled in for state specific information.

f) The model notice itself should be rewritten to meet more basic literacy standards. The current notice uses complex language, compound sentences, and long paragraphs. This notice should be much more user friendly and should be written to be readable at no more than an 8th grade reading level.

6. Section 212.8(b) Should be Clarified to Avoid Support for Bank Setoffs Against Exempt Funds. Section 212.8(b) currently states that "Nothing in this part shall be construed to invalidate any term of condition of an account agreement . . . that is not inconsistent with this part." Most account agreements include terms permitting the financial institution to seize funds in the account for debts owed to the bank. A number of cases have held that this is not legal when exempt funds are seized.[53]

The intended purpose of Section 212.8(b) is not clear. However, it could be used to legitimize and support a financial institution's illegal and inappropriate set-off of exempt federal funds against debts owed to the financial institution. This proposed rule does not deal with bank set-offs and it should not be used to provide support for an illegal act.

Recommendation - Section 212.8(b) should be deleted.

7. Section 212.10(b) - Safe harbor to Financial Institutions Is Unclear and Confusing and Does Not Go Far Enough – Back Payments are Unprotected. There are two separate issues with the Safe Harbor language. The first is that the language is unclear, and, because of that confusion, potentially dangerous. The second is that the language does not adequately protect banks who want to do the right thing and release unquestionably exempt funds which are not included in the protected amount.

a. Clarifying Safe Harbor. The language in subsections (a) and (b) of section 212.10 is confusing. In subsection a, the language ("A financial institution that complies in good faith with this part shall not be liable … to an account holder for any frozen amounts") appears to permit or

[52] This information is readily available from local bar associations or directly from the Legal Services Corporation of America. *See* http://www.rin.lsc.gov/rinboard/rguide/pdir.idc.

[53] *Tom v. First Am. Credit Union*, 151 F.3d 1289 (10th Cir. 1998) (noting that there is no relevant difference between set-off and garnishment and prohibiting set-off against exempt funds); *Hambrick v. First Security Bank*, 336 F. Supp.2d 890 (E.D. Ark. 2004) (Social Security's anti-assignment provision prohibited application of bank's set-off provisions in bank customer's agreements with bank); *Marengo v. First Massachusetts Bank, N.A.*, 152 F.Supp.2d 92, (D. Mass. 2001) (bank's set-off against Social Security funds violated Social Security Act); *In re Brewer*, 2002 WL 32917680 (Bankr. S.D. Ill. Aug. 15, 2002) (42 U.S.C. § 407(a) prohibits credit union from taking debtor's Social Security funds regardless of the prior agreement of the debtors that the subject funds would act as collateral for their loans from the credit union).

even require a freezing of the funds in the account before the protected amount is determined. But that cannot be the case, because it would undermine the entire purpose of this excellent regulation.

> (a) *Protection during examination and review*. A financial institution that complies in good faith with this part shall not be liable to a judgment creditor for any protected amounts, to an account holder for any frozen amounts, or for any penalties under state law, contempt of court, civil procedure, or other law for failing to honor a garnishment order for account activity during the one business day following the financial institution's receipt of a garnishment order. (emphasis added).

Does this give the financial institution authority to freeze all of the funds in the account on the day it receives the garnishment order, while it is determining the protected amount? This seems to conflict with the intent, if not the explicit wording of Section 212.6. That section appears to require the bank to follow a process: receive the garnishment order, look at the account during the lookback period, define the protected amount, freeze the appropriate amount over the protected amount.

There should not be any freezing of funds before the protected amount is determined. Also there cannot be protected amounts before the examination, because the examination is necessary to determine the protected amount.

The reference to the bank's liability "to an account holder" is particularly confusing. There is no need for any safe harbor for banks as against account holders under this rule, because there is nothing in the rule that permits the banks to do anything more than they are otherwise permitted or required to do under state law. This regulation needs to protect banks against judgment creditors, not against account holders. If the bank wrongly figures the protected amount, then the bank has not complied with the rule and no protection will be provided in any case. The language of subsection (a) could even be read to relieve the bank of its duty to release to the account holder funds in addition to the protected amount that the bank or a court determined were exempt. If there is some potential liability that the bank might have *to the account holder* by following this rule, it should be clearly spelled out and treated in a separate section of the rule, rather than mixed into a long and confusing safe harbor rule that deals with different potential liabilities to different parties.

To clarify subsection (a), the language should be changed as follows (new language is in **bold**):

> (a) *Protection during examination and review*. A financial institution that complies in good faith with this part shall not be liable to a judgment creditor for any **funds which would have been frozen under state law after the examination and review, or for any** protected amounts, ~~to an account holder for any frozen amounts,~~ or for any penalties under state law, contempt of court, civil procedure, or other law for failing to honor a garnishment order for account activity during the one business day following the financial institution's receipt of a garnishment order.

A parallel revision should be made to subsection (b), which includes the same confusing language. Subsection (b) is discussed in more detail in the next section.

b. Expanding the Safe Harbor to protect banks to the fullest extent when they decline to freeze or turn over exempt funds. Many state laws on garnishment instruct financial institutions to seize only non-exempt funds.[54] Even before the publication of this proposed regulation, a number of large financial institutions promulgated policies providing that if exempt and non-exempt funds have not been commingled, the exempt funds will be not be seized.

Recipients often set aside large back-payments in special savings accounts or CDs. Such accounts are frequently untouched for years, with no additional funds deposited. The funds are unquestionably exempt; however, they would not be protected from seizure under the proposed rule because the deposit would have been made well before the lookback period. In addition, in many cases even an account holder who does not have a special savings account or CD will have saved up a small amount of exempt benefits over and above the protected amount, often in an account that consists solely of exempt benefit payments.

Currently, many financial institutions receiving state garnishment instructions that require only exempt funds to be seized will not seize funds in such accounts due to the obvious nature of the exempt status. Even if the institution seizes the funds, recipients often ask the financial institution to release the funds. If the recipient is able to demonstrate to the financial institution that the funds are exempt, the financial institution should be protected for releasing the funds to the recipient. However, under the system proposed by these regulations, the bank that recognizes the exempt status of funds deposited prior to the lookback period and refuses to seize them would not be protected from challenges from the judgment creditor.

Subsection 212.10(b) does not provide financial institutions sufficient safe harbor in this instance. Another provision needs to be added to accomplish this objective. Financial institutions should be encouraged to protect exempt funds that are readily identifiable, and should be protected from liability when they do so. Financial institutions should not only be permitted but encouraged to release these exempt funds to recipients either on their own accord or after a request to do so by the recipient.

In proposing this expansion of the safe harbor, we are *not* asking that banks be required to review the exempt status of funds deposited prior to the lookback period. Our proposal would simply protect the financial institution from creditor challenges when it reviewed the status of those funds of its own accord and released them to the account holder.

Recommendation – Section 212.10(b) should be rewritten as follows, with new language in bold:

> "(b) General protection for financial institutions. A financial institution that complies in good faith with this part shall not be liable to a judgment creditor for any protected amounts, ~~to an account holder for any frozen amounts~~, or for any penalties under state law, contempt of court, civil procedure, or other law for failing to honor a garnishment order in cases where -

[54] California – West's Ann.Cal.C.C.P. § 704.080; Missouri – Mo. Rev. Stat. § 513.430; Nevada – Nev. Rev. Stat. § 31.249(2)(b); Vermont – 12 Vt. Stat. Ann. § 2732.

(1) A benefit agency has deposited a benefit payment into an account during the lookback period or

(2) The financial institution has determined that an order was obtained by the United States by following the procedures in Sec. 212.4(a)(1) and (2); **or**

(3) The financial institution, after a review of its own records, releases to the account holder benefit payments as defined by this Part."

Conclusion

The Treasury Department has led a remarkable effort. We congratulate and thank all of the federal agencies involved with this rule proposal. With the changes suggested above, this rule would successfully address a serious problem affecting hundreds of thousands of elderly and disabled Americans every year.